DEC 22 1954
HAROLD B. WILLEY, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1954

No. 493

LEON R. MEYER, *Petitioner,*

vs.

THE UNITED STATES OF AMERICA.

LUCILE H. MEYER, *Petitioner,*

vs.

THE UNITED STATES OF AMERICA.

LEON R. MEYER, TRANSFEREE OF MEYER JEWELRY COMPANY, *Petitioner,*

vs.

THE UNITED STATES OF AMERICA.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS.

HOMER CUMMINGS,
ALBERT L. REEVES, JR.,
WILLIAM D. DONNELLY,
Counsel for Petitioner,
1625 K Street,
Washington, D. C.

CUMMINGS, STANLEY, TRUITT, CROSS & REEVES,
Of Counsel.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

INDEX

	Page
Opinion Below	2
Jurisdiction	2
Questions Presented	2
Statute Involved	3
Statement	3
Reasons for Granting the Writ	5
Conclusion	9
Appendix: Opinion and judgment below	1
Findings of fact and conclusion of law	14

CITATIONS

Cases:

Helvering v. *Alabama Asphaltic Limestone Co.*, 315 U.S. 179	5
Isaacs v. *Hobbs Tie & Timber Co.*, 282 U.S. 734	8
Mascot Stove Co. v. *Commissioner*, 120 F. 2d 153	6, 7
Mueller v. *Nugent*, 184 U.S. 1	8
Northern Pacific Ry. Co. v. *Boyd*, 228 U.S. 482	5
Quincy, M. & P. R. Co. v. *Humphreys*, 145 U.S. 82	8
Templeton's Jewelers, Inc. v. *United States*, 126 F. 2d 251	6, 7
United States v. *Weitzel*, 246 U.S. 533	8

Statutes:

Revenue Act of 1928, c. 852, 45 Stat. 791	3
Sec. 112(a)	3
Sec. 112(b)(3)	2, 3, 4, 5, 8

IN THE

Supreme Court of the United States

OCTOBER TERM, 1954

No.

LEON R. MEYER, *Petitioner,*

vs.

THE UNITED STATES OF AMERICA.

LUCILE H. MEYER, *Petitioner,*

vs.

THE UNITED STATES OF AMERICA.

LEON R. MEYER, TRANSFEREE OF MEYER JEWELRY COMPANY, *Petitioner,*

vs.

THE UNITED STATES OF AMERICA.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS.

The plaintiffs in the consolidated cases below pray that a Writ of Certiorari issue to review the judgment therein of the United States Court of Claims.

OPINION BELOW.

The opinion and judgment of the Court of Claims (R. 55-66) are reported at 121 F. Supp. 898, and, together with that court's findings of fact (R. 66) and conclusion of law (R. 82) are printed in the Appendix to this petition.

JURISDICTION.

The judgment of the Court of Claims was entered on June 8, 1954 (R. 55, 66). Plaintiffs' motion for rehearing was timely filed August 30, 1954, (R. 83) pursuant to extension of time duly granted (R. 83), and was denied by order entered October 5, 1954 (R. 83). The jurisdiction of this Court is invoked under 28 U. S. C., Section 1255.

QUESTIONS PRESENTED.

1. Whether Section 112 (b) (3) of the Revenue Act of 1928, providing for tax-free corporate reorganizations, is limited in its application to solvent corporations so that stockholders of an insolvent corporation may never have the benefit thereof, even though creditors voluntarily and intentionally reduce and settle their claims so as to assure the retention by the stockholders of the equity in the reorganized corporation.

2. Whether the right of creditors to exclude stockholders from the reorganization of an insolvent debtor under the *full priority rule,* as announced and explained by the Supreme Court of the United States, must conclusively be deemed to have been exercised as a matter of law, even though it has not been exercised as a matter of fact, but, to the contrary the creditors have voluntarily and intentionally reduced and settled their claims so as to assure the retention of the equity by the stockholders.

STATUTE INVOLVED.

Revenue Act of 1928, c. 852, 45 Stat. 791, 816:

Sec. 112. RECOGNITION OF GAIN OR LOSS

"(a) General rule.—Upon the sale or exchange of property the entire amount of the gain or loss, determined under Section 111, shall be recognized, except as hereinafter provided in this section.

"(b) Exchanges solely in kind.—

* * * * * * * * * * *

"(3) Stock for Stock on Reorganization.—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

STATEMENT.

Meyer Jewelry Company having encountered financial difficulties, a receiver was appointed on March 19, 1931, upon the application of certain of its creditors made at the suggestion of (Tr. 161), and joined in by, the debtor corporation (Fdgs. 12, 13, App'x. 17). While the receivership proceedings were pending, the debtor arranged for a settlement of its liabilities of approximately $88,000 for $22,000, plus administrative and court costs of $6,500 (Fdg. 16), and, pursuant to a written plan of reorganization (Fdg. 17) and with the full knowledge, consent and approval of all of its creditors (Fdg. 15, Tr. 26-29, 44, 45, 49, 50) its assets were acquired by a new corporation with the same name and with the same stockholders—each having a proprietary interest in the new corporation in the same proportion as his interest in the old corporation (Fdg. 18). The stock of the old corporation was turned in and cancelled and the new stock was issued to the same stockholders with no money being paid therefor (Fdg. 18). To repeat, the creditors desired that the stockholders of the old corporation retain the proprietary interest in the new company; the creditors deliberately and intentionally

elected not to eliminate the interests of the stockholders; the stockholders did, in fact, retain an equity having a very substantial actual value. Upon the termination of the receivership proceedings, the equity of the stockholders in the reorganized company was worth in excess of $50,000 (Fdg. 18). The new corporation received and owned the same assets as the old corporation (Fdg. 18).

In July, 1943, the reorganized corporation was liquidated and its assets were distributed to its sole stockholders, Petitioner Leon R. Meyer (plaintiff in case No. 49739) and Petitioner Lucile H. Meyer (plaintiff in case No. 49740) in exchange for their stock (Fdg. 24). In determining the gain to the stockholders on this exchange, the Commissioner of Internal Revenue refused to permit them to carry over as part of the basis of their stock the basis of the stock of the old corporation (Fdg. 28). The Commissioner also determined that the reorganized Meyer Jewelry Company (transferor of plaintiff in case No. 49741) was not entitled to use the capital surplus account of the old corporation in computing equity invested capital of the reorganized company (Fdg. 27). The plaintiffs paid individual income taxes and corporate excess profits taxes in the amounts determined by the Commissioner (Fdgs. 28, 29) and brought suit for refund in the Court of Claims which dismissed their petitions. All three cases turned on the single issue of whether Meyer Jewery Company experienced a tax-free reorganization within the meaning of Section 112 (b) (3) of the Revenue Act of 1928.

The Court of Claims, in denying petitioners' claims, found that in 1931 the Meyer Jewelry Company was insolvent in the bankruptcy sense, and, upon the basis of this finding, concluded as follows:

> (a) notwithstanding the fact that all of the creditors voluntarily and intentionally reduced and settled their claims so as to assure the retention by the stockholders of the equity in the reorganized company, yet

under the *full priority rule* of *Northern Pacific Ry. Co.* v. *Boyd,* 228 U. S. 482, 33 S. Ct. 554, the interest of the stockholders was nonetheless eliminated as a matter of law;

(b) therefore, the requisite continuity of interest was lacking;

(c) therefore, although all other requirements of a tax-free reorganization had been met, the fact of insolvency, in and of itself, precluded Meyer Jewelry Company from experiencing a tax-free reorganization.

REASONS FOR GRANTING THE WRIT.

1. The decision below erroneously applied the *full priority rule* of this Court in *Northern Pacific Ry. Co.* v. *Boyd,* 228 U. S. 482 and *Helvering* v. *Alabama Asphaltic Limestone Co.,* 315 U. S. 179, and, in effect, amended Section 112 (b) (3) of the Revenue Act of 1928 by judicial decree.

The *full priority rule* was announced by this Court in the *Northern Pacific* case, *supra,* as follows, l. c. 482:

> "Corporations, insolvent or financially embarrassed, often find it necessary to scale their debts and readjust stock issues with an agreement to conduct the same business with the same property under a reorganization. This may be done in pursuance of a private contract between bondholders and stockholders. And though the corporate property is thereby transferred to a new company, having the same shareholders, the transaction would be binding between the parties. But, of course, such a transfer by stockholders from themselves cannot defeat the claim of a nonassenting creditor."

and was explained by this Court in the *Alabama Asphaltic Limestone* case, 315 U. S. 179, as follows (p. 183-184):

> "The full priority rule of *Northern Pacific Ry. Co.* v. *Boyd,* 228 U. S. 482, applies to proceedings in bankruptcy as well as equity receiverships. *Case* v. *Los Angeles Lumber Products Co.,* 308 U. S. 106. It gives

> creditors, whether secured or unsecured, the right to exclude stockholders entirely from the reorganization plan when the debtor is insolvent."

Summarized, the *full priority rule* of this Court is that creditors of an insolvent corporation are entitled, if they so choose, to eliminate the interest of stockholders. The *full priority rule* is not a conclusive test of a tax-free corporate reorganization; it is a protective rule for the benefit of creditors if they choose to invoke it. But here the creditors, with full knowledge of all of the facts, ably represented by counsel, and acting in their own self-interest, desired that the business be continued under the same management, and, to accomplish such purpose, deliberately and intentionally consented that the stockholders of the old company retain the equity.

In the face of those undisputed facts, the Court of Claims in its opinion held, 121 F. Supp. 898, 904 (R. 63, App'x. pp. 10-11):

> "Therefore, since the old corporation was insolvent in the bankruptcy sense, the creditors, under the full priority rule of *Northern Pacific Ry. Co.* v. *Boyd*, 228 482, could have and *in fact did, as a matter of law,* eliminate the interest of the stockholders in the old corporation." (Emphasis supplied)

Because of the *apparent* similarity between the facts in the Meyer Jewelry Company reorganization and the facts in *Mascot Stove Co.* v. *Commissioner*, 120 F. 2d 153, and in *Templeton's Jewelers, Inc.* v. *United States*, 126 F. 2d 251 (both decided by the Sixth Circuit Court of Appeals with opinion in both cases by Judge Simons), the Court of Claims fell into the error of assuming that the decisions announced in those cases should govern here. However, in neither of those cases did the creditors desire and consent that the stockholders retain the equity in the reorganized company, nor did the stockholders in fact retain the equity in the reorganized company. Therefore, although the *full priority rule* may have been properly applied as the key-

stone of the decision in *Mascot Stove Co.* (on which *Templeton's Jewelers, Inc.*, depends), that rule is not applicable under the factual situation of the Meyer Jewelry Company reorganization. The record is clear that the creditors of Meyer Jewelry Company neither desired nor intended to wipe out the stockholders' equity; on the contrary, they desired and provided for such equity and a continuity of interest. There was, in substance and in reality, a simple settlement of an indebtedness of $88,000 for $22,000.

To say, as did the Court of Claims, that the creditors of Meyer Jewelry Company "could have and in fact did, as a matter of law, eliminate the interest of the stockholders in the old corporation" not only disregards the undisputed facts, but also diverts the *full priority rule* from the role assigned to it by this Court of protecting creditors in the assertion of their rights to the role of protecting them against their wishes and their own judgment of their best interests. As applied by the Court of Claims the *full priority rule* becomes a conclusive presumption of law under which the actual facts and the wishes of the creditors are disregarded. Cases should be decided on actual facts; conclusive legal presumptions to the contrary should only be resorted to in cases involving matters of public policy.

2. The decision of the Court of Claims in the cases below that Meyer Jewelry Company was insolvent in a bankruptcy sense is contrary to its own findings of fact. The Court of Claims actually found: (a) that the merchandise inventory alone as shown on the books of the old corporation had a book value of $107,651.97 (Fdg. 14, App'x 18); (b) that the appraisers appointed in the receivership proceedings valued the assets of the old corporation at $50,211 on the basis of present cash value (not on the basis of a going concern) (Fdg. 14); (c) that the net effect of the settlement of the debts of the old corporation was to increase the book equity of the stockholders by approximately $59,485 (Fdg. 18, App'x 25); (d) that the new corporation received and owned the same assets as the old corporation had held prior to the receivership and that no part

thereof had been liquidated by the receiver (Fdg. 18); (e) that the equity of the stockholders in the new corporation, upon receiving the same from the old corporation, had a book value of $51,161.68, even after the new corporation took a voluntary writedown of $62,751.31 (Fdg. 18, App'x 25).

Obviously, when the liabilities of the old corporation were scaled down to $28,515 with the consent of all of the creditors (Fdg. 16, App'x 10; Tr. 26-29, 44, 45, 49, 50) the old corporation was solvent. To substantiate its conclusion of insolvency in the bankruptcy sense, the Court of Claims necessarily ignored the facts that the settlement with creditors (assented to by them) was made by the old corporation as a part of a plan of reorganization adopted shortly following the filing of the receivership proceedings (Fdg. 17), and that the settlement had been agreed to in the receivership proceedings prior to the acquisition of the assets by the new corporation (Fdg. 16, 17). The Court of Claims in effect has attempted to substantiate its conclusion by stating that since the creditors "could have" they "in fact did, as a matter of law, eliminate the interest of stockholders in the old corporation",—that is to say, that even though the creditors in actuality did settle and reduce the liabilities of the old corporation, still, as a matter of law, they must be presumed not to have done so.

In respect of the essentials of continuity of interest and retention of equity, the Court of Claims also refused to recognize an important distinction between bankruptcy and equity receivership, namely, that in the former title passes by operation of law to the trustee in bankruptcy (*Isaacs* v. *Hobbs Tie & Timber Co.*, 282 U. S. 734; *Mueller* v. *Nugent*, 184 U. S. 1); while in the latter title remains in the debtor, its property being merely in the custody of the Court (*United States* v. *Weitzel*, 246 U. S. 533; *Quincy, M. & P. R. Co.* v. *Humphreys*, 145 U. S. 82).

3. The limitation judicially appended by the Court of Claims to Section 112 (b) (3) of the Revenue Act of 1928 adversely affects a great number of taxpayers, since the

language of the section has been incorporated substantially without change in all succeeding revenue acts. The *full priority rule* is not limited to tax cases, but is of importance in defining generally the respective rights of creditors and stockholders of insolvent corporations.

CONCLUSION.

For the foregoing reasons, we respectfully submit that the Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

HOMER CUMMINGS,
ALBERT L. REEVES, JR.,
WILLIAM D. DONNELLY,
Counsel for Petitioner,

CUMMINGS, STANLEY, TRUITT, CROSS & REEVES,
Of Counsel.

December , 1954.